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BEFORE THE ARIZONA CORPORATION COMMISSION

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JIM IRVIN  
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RENZ D. JENNINGS  
COMMISSIONER  
CARL J. KUNASEK  
Commissioner

IN THE MATTER OF THE COMPETITION ) DOCKET NO. RE-00000C-94-0165  
IN THE PROVISIONS OF ELECTRIC )  
SERVICES THROUGHOUT THE STATE ) OPENING BRIEF OF  
OF ARIZONA ) NAVOPACHE ELECTRIC  
 ) COOPERATIVE ON  
 ) STRANDED COSTS

Navopache Electric Cooperative, Inc. hereby submits the attached as its opening brief on the issue of stranded costs in the above captioned matter. In keeping with the Hearing Officer's indication that he would limit his review of the briefs to ten (10) pages chosen at random, Navopache has limited its OPENING BRIEF to a seven (7) page discussion of its position on each of the issues posed by the Hearing Officer.

RESPECTFULLY SUBMITTED this 16th day of March, 1998.

MARTINEZ & CURTIS, P.C.

By *William P. Sullivan*

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DISCUSSION OF NAVOPACHE'S POSITION  
ON EACH OF THE QUESTIONS  
POSED BY THE HEARING OFFICER

**QUESTION NO. 1:** Should the Competition Rules be modified as they relate to stranded costs? If so, how should they be modified?

**Answer:** No.

**Discussion:** The current rules provide a generally acceptable definition of stranded costs, place a reasonable burden on the affected utilities to mitigate stranded costs as a condition to full recovery of stranded costs and, most importantly, retain the necessary flexibility to deal with each utility's unique circumstances. Flexibility is essential due to the varied circumstances facing the affected utilities in Arizona.

The testimony demonstrated that each affected utility is unique with regard to stranded costs. For example, as compared to investor owned utilities, cooperatives have no profit motive, have no separate class of shareholders to absorb stranded costs, are more heavily debt leveraged, are mortgagees to the United States of America, serve areas with low customer densities and possess all-requirements power contracts. Even as between investor owned utilities, the potential stranded costs and the options to mitigate them vary significantly. The unique circumstances must be examined on a case by case basis in order to properly deal with stranded costs.

The changes proposed to the Rules by various parties would reduce or eliminate the flexibility needed to appropriately deal with the unique issues facing the various affected utilities. In fact, the changes are proposed to eliminate flexibility and adopt concepts favoring the proposing party's particular bias. The evidence tended to be predictable based upon the group advocating the position. For example, generators generally proposed changes to move closer to full recovery of stranded costs, those desiring to enter a competitive generation market sought changes which would limit the imposition of stranded costs recovery on them or their potential customers, while consumer groups sought to foreclose the utility's ability to fully recover their stranded costs. The current rules require the Commission to evaluate these positions in context of each affected utility.

Embarking on amending the Rules at this juncture would threaten to delay the onset of competition and only increase litigation over the reasonableness of the Commission's rules.

A far more productive course of action would be for the Commission to issue an order stating non-binding preferences which it has developed based on the testimony given in this docket. The affected utilities would then be on notice that the preference needs to be dealt with in their filing. For example, if the Commission concludes divestiture of generation is a viable option which should be considered in approving a recovery mechanism for stranded costs, the order could require each stranded cost filing to include: (1) an itemization of the components to be included in the stranded cost charge (e.g., each plant and purchase power contract, including regulatory assets, directly associated therewith); (2) the current book value of each such asset; (3) if the utility contends the asset has been recognized by the Commission, the basis of that contention, including the value recognized by the Commission; (4) the utility's arguments for and against proceeding with the divestiture of all or a portion of its stranded assets for which it seeks cost recovery (5) a proposal to divest any stranded assets which are not essential to meet obligations to standard offer customers (the utility would have the option to explain why all or a portion of its generation assets should not be subject to sale).

Similarly, the Order could indicate individual mitigation programs should accompany the filing for stranded cost recovery and further provide that the Commission reserves the right to assign a share of the risk of stranded cost recovery to shareholders if the proposed mitigation program does not adequately seek to mitigate stranded costs which are demonstrated to be subject to mitigation.

Navopache believes such an approach allows the filing utilities to have a sense of what is expected of them while requiring the Commission to review the stranded cost recovery proposals in the context of the particular affected utility without restricting the outcome by arbitrary requirements such as a general divestiture obligation or a pre-determined allocation of a portion of stranded costs to shareholders.

**Question No. 2:** When should Affected Utilities make stranded cost filings?

**Answer:** Six months prior to effective date of rates.

**Discussion:** Those seeking to compete in the generation market argue a stranded cost filing is essential so customers will know their potential costs in evaluating alternative suppliers. This concern, although legitimate, must be balanced against the time necessary to gather the information necessary to establish stranded costs, as well as the time necessary for the Commission to consider the filing.

Any adverse impact from delay will be eliminated by limiting applicability of stranded cost charges to contracts entered into after the effective date of the tariff, except for good cause shown. This would also preclude recovery of stranded costs arising from those contracts entered into prior to the effective date of the tariff.

**Question No. 3:** What costs should be included in stranded cost filings?

**Answer:** The present definition is appropriate.

**Discussion:** Under the present definition the primary stranded costs anticipated for Navopache are costs related to debt for distribution infrastructure, and its purchased power contracts. Other costs, like employee related costs, billing and meter reading costs, may be stranded under certain circumstances. No stranded costs are present where the output of existing generation is fully utilized and the utility would have to purchase power to meet the load served by a competitor.

The G & T's recovery of its stranded costs can impact the level of stranded costs for the distribution cooperative, as well as the method of calculating those costs.

Affected Utilities should be allowed to recover all prudently incurred costs the utility can demonstrate were incurred as a result of entry into an era of competition; subject to the utility taking all reasonable efforts to mitigate those costs.

We envision the Commission's Order arising from this hearing would indicate any category of costs the Commission has concluded, from the testimony presented, is unlikely to be recoverable and any category which is clearly recoverable.

**Question No. 3a:** What is the recommended calculation methodology, and what assumptions are made, including determination of market clearing price?

**Answer:** Where feasible to sell the stranded asset, the sale price should be used. Otherwise the Net Revenues Lost method should be used. The market price should take into consideration the appropriate mix of long term, short term and intermediate term contract prices.

**Discussion:** The sale of generation and associated assets will provide the most accurate market price of existing generation. However, Navopache does not support a forced divestiture of generation assets. As noted above all stranded assets and the book value thereof should be identified in any stranded cost recovery filing. Moreover, the affected utility should explain why divestiture of those assets will, or will not, be pursued and the reasons behind that decision. These factors would be considered in evaluating the mitigation program proposed by the affected utility.

Where sale is not reasonably available, Navopache advocates the Net Revenues Lost approach. This approach reflects a net present value calculation of the net revenues of sales from the utility's stranded assets, adjusted to reflect the present value of the stream of avoidable power production costs. A model can be constructed to examine various scenarios and weight the probability of each. The market price of generation should reflect its highest reasonably expected value in the market place. Where an administrative process is used to calculate stranded costs, the best estimate of the average price paid for electricity in the competitive market must take into consideration not only spot market purchases, but also prices paid for electricity purchased under short, medium and long term contracts.

**Question No. 3b:** What are the implications of SFAS No. 71 resulting from the recommended stranded cost calculation and recovery methodology?

**Answer:** Navopache did not attempt to answer this question directly.

**Discussion:** Karen Kissenger provided a good overview of the interplay between Commission action and how expenses are treated for accounting purposes. The testimony supports the proposition that the Commission should not act to precipitously require write-down or write-off of generation assets. On the other hand, where upon review of a particular utility's proposed stranded cost recovery mechanism, including its mitigation program, the Commission concludes certain assets or a portion

thereof will not be recovered, such information should be conveyed as soon as possible so that the utility can make the necessary adjustments to its books and the financial markets can properly deal with this information

**Question No. 4:** What limitation should be placed on the stranded cost calculation period?

**Answer:** The Affected Utility should be allowed to calculate stranded costs only over the period where an asset is stranded due to competition. In no event should the recovery exceed the lesser of the average book life of the stranded assets, or fifteen years.

**Discussion:** Some assets may be initially stranded, but over time have a value greater than book. For example a new mix of generation may make a particular asset more valuable. Thus there is great uncertainty about future costs and revenues, requiring commensurably large discount rates. Going beyond fifteen years will provide little benefit because of the impact of the discount to present value.

**Question No. 5:** What limitation should be placed on the stranded cost recovery period?

**Answer:** The recovery period should be set on a utility by utility basis, depending on the nature of the stranded costs involved and the level of stranded cost charge. A seven year cap could be imposed to provide a clear signal to consumers and the competitive market place that the full impacts of a competitive marketplace will not be long delayed.

**Discussion:** There should be an attempt to eliminate the stranded cost charge as soon as possible to allow the price to reflect the market value. However, the desire to reach a true competitive marketplace should be balanced against the magnitude of the stranded cost charge. The magnitude of stranded costs is a function of time. Navopache believes a seven year recovery period should be sufficient to achieve a reasonable balance.

**Question No. 6:** How and who should pay stranded costs and who, if anyone, should be excluded?

**Answer:** A separate non-bypassable stranded cost charge would apply only to the competitive market.

**Discussion:** An implicit stranded cost charge is a component of the standard offer. The stranded cost component contained in the standard offer could be separately set forth. No double recovery should be permitted.

The stranded cost charge could be computed as a kW charge or a kWh charge or a dollars per month charge. The charge most consistent with a competitive market place is anticipated to be the kWh charge. At least for heavily debt leveraged utilities, like cooperatives, revenues received from this charge should flow directly to pay off any debt component of the stranded cost.

**Question 7:** Should there be a true-up mechanism? If so, how should it operate?

**Answer:** If generation is sold in a free marketplace, no true-up mechanism is necessary. Otherwise, there should be a review every one or two years to reset the charge. However, the charge should not be retroactively imposed. An abbreviated hearing similar in scope and character to a fuel and purchased power cost adjustment review should be used.

**Question No. 8:** Should there be price caps or a rate freeze imposed as part of the development of a stranded cost recovery program and, if so, how should they be calculated?

**Answer:** No.

**Discussion:** Navopache does not support a blanket cap or freeze as part of the stranded cost recovery mechanism. However, when individual proposals are evaluated, especially where the utility has not demonstrated it has taken all reasonable steps to mitigate stranded costs, a rate cap may be an acceptable method of dealing with the failure to implement a proper mitigation program. Any rate cap should be limited to the costs imposed under the stranded cost recovery mechanism. The Commission must not preclude the recovery of prudently incurred costs, such as increased debt costs, simply because competition is permitted in the generation arena.

**Question 9:** What factors should be considered for mitigation of stranded costs?

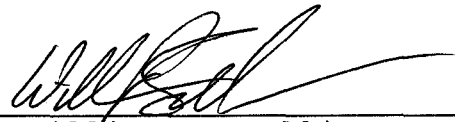
**Answer:** This must be a utility specific inquiry.

**Discussion:** We suggest the Commission require any utility seeking recovery of stranded costs set forth a specific mitigation program. Generally, a mitigation program might include selling energy at wholesale or retail in other markets, sale of non-traditional services, cost-cutting, divestiture, merger, acquisition, debt refinancing, restructuring power contracts and reorganizing management and staff.

RESPECTFULLY SUBMITTED this 16th day of March, 1998.

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**PROOF OF AND  
CERTIFICATE OF MAILING**

I HEREBY CERTIFY that on this 16TH day of March, 1998,  
I caused the foregoing document to be served on the Arizona  
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